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Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Petition of U S WEST Communications, Inc.	)	CC 98-157
for Forbearance from Regulation as a	)	
Dominant Carrier in the Phoenix, Arizona	)	
MSA	)	

PETITION OF U S WEST COMMUNICATIONS, INC. FOR FORBEARANCE

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SUMMARY

U S WEST Communications, Inc. ("U S WEST"), pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"), hereby submits this Petition requesting that the Federal Communications Commission ("Commission") exercise its authority to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity services in the Phoenix, Arizona Metropolitan Statistical Area ("MSA").

In its Petition, U S WEST demonstrates that the Phoenix area market for high capacity services is robustly competitive. U S WEST faces intense competition from both resellers and five established facilities-based competitors with substantial resources and extensive fiber networks. These established companies, which include the combined AT&T/TCG and MCI/MFS WorldCom companies, have access to financial resources equal to or greater than U S WEST's with which to fund expansion of their networks.

Following the approach that the Commission used to assess market power in the AT&T non-dominant proceeding and other proceedings, Professors Alfred E. Kahn and Timothy J. Tardiff conclude that U S WEST lacks market power in the Phoenix area market for high capacity services. First, U S WEST has a steadily declining market share. The attached market analysis conducted by Quality Strategies demonstrates that competitive providers have captured more than 70 percent of the retail market for high capacity services. Moreover, it is important to note that competitive providers' market share has been growing even more rapidly

than the rapid growth in the demand for high capacity services in the Phoenix area. Perhaps the most important trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured about half of the growth in demand for high capacity services.

Second, there is high demand elasticity. The customers that tend to purchase high capacity facilities – medium to large businesses, governmental entities and other carriers – are highly sensitive to price and other service characteristics. The ability of U S WEST's largest carrier customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability.

Third, there is high supply elasticity. Competitive providers have deployed more than 800 route miles of optical fiber in the Phoenix MSA. These extensive fiber backbone networks could handle all of U S WEST's end user and transport traffic at less than <u>eight percent</u> capacity. A majority of U S WEST's current high capacity demand is located within 100 feet of the competitive providers' networks, which means that it could be absorbed almost immediately at minimal cost. Moreover, as the attached report prepared by POWER Engineers, Inc. demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand. In addition, the impressive growth of competitive providers' market share demonstrates that the cost of entry is not prohibitive.

Fourth, U S WEST does not enjoy an advantage in terms of its costs, structure, size and resources. Indeed, the combined A&T/TCG and MCI/MFS WorldCom companies have a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services. The presence of competitive activity in the market while prices are dropping steadily is a strong indication that U S WEST does not have an insurmountable cost advantage in the market.

In light of U S WEST's lack of market power, Kahn and Tardiff conclude that competition, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of service. Therefore, U S WEST seeks forbearance from various dominant carrier regulations, including the requirement that U S WEST file tariffs on up to 15-days notice with cost support, price cap and rate of return regulation, and the requirement that U S WEST charge averaged rates throughout the State of Arizona (i.e., the Arizona study area).

U S WEST's Petition satisfies the three criteria of Section 10. First, because U S WEST lacks market power, dominant carrier regulation is not necessary to ensure that its rates and practices are just, reasonable and not unreasonably discriminatory. Moreover, other regulations (such as Sections 201 and 202 of the Communications Act of 1934, as amended) are sufficient to ensure that U S WEST does not attempt to charge unreasonable rates. Second, for these same reasons, dominant carrier regulation is not necessary to protect consumers. Third, forbearance from applying dominant carrier regulation to U S WEST's high capacity services is consistent with the public interest.

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PETITION OF U S WEST COMMUNICATIONS, INC. FOR FORBEARANCE

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"),[1] hereby submits this Petition requesting that the Federal Communications Commission ("Commission") exercise its authority to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity services[2] in the Phoenix, Arizona Metropolitan Statistical Area ("MSA"). This includes forbearance from enforcing the Commission's Part 61 tariff rules as they apply to dominant carriers and any other rules affecting high capacity services which result in different regulatory treatment for dominant and non-dominant carriers.

U S WEST's Petition is limited in scope both geographically and the services covered by it. Furthermore, it does not present any novel questions of law or fact which might prolong the

[1] 47 U.S.C. § 160.

[2] Specifically, U S WEST seeks regulatory relief for special access and dedicated transport for switched access at DS1 and higher transmission levels (e.g., DS1, DS3 and OCn). No relief is sought for other interstate services, such as switched access and special access and dedicated transport at DS0 and voice grade transmission levels.

Commission's analysis. Therefore, U S WEST requests that the Commission treat this Petition in an expedited manner in order to bring the full benefits of competition to the Phoenix area market at the earliest possible date.[3]

I. INTRODUCTION

One of the key pro-competitive provisions Congress included in the 1996 Act is Section 10, which requires the Commission to forbear from applying any regulation or provision of the Act if the Commission determines that: (1) enforcement is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory; (2) enforcement is not necessary to protect consumers; and (3) forbearance is consistent with the public interest.[4] In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition.[5] The statutory imperative created by Section 10 reflects Congress's reasoned judgment that competition, not government regulation, should guide companies' behavior in competitive telecommunications markets.

In the sections which follow, U S WEST demonstrates that the market for high capacity services in the Phoenix MSA is robustly competitive. U S WEST faces intense competition from both resellers and five established facilities-based

[3] Under Section 10, in the absence of an extension, the Commission has one year to act on a forbearance petition before it is deemed to be granted. 47 U.S.C. § 160(c).

[4] 47 U.S.C. § 160(a)(1)-(3).

[5] 47 U.S.C. § 160(b).

competitors with substantial resources and extensive fiber networks. These established companies – Electric Lightwave, Inc. ("ELI"), GST Telecommunications, Inc. ("GST"), MCI Telecommunications Corporation ("MCI"), MFS WorldCom and Teleport Communications Group ("TCG") – have access to financial resources equal to or greater than U S WEST's with which to fund expansion of their networks. Equally as important, the recently completed merger of TCG with AT&T Corp. ("AT&T"), and the pending merger of MCI with MFS WorldCom, will result in the two largest purchasers of high capacity services in Phoenix (AT&T and MCI) having their own competitive fiber networks. U S WEST already is experiencing the effects of these mergers, as significant portions of these customers' high capacity services have been migrated to the affiliated fiber networks.[6]

U S WEST's steadily declining market share for high capacity services in the Phoenix market supports the finding that U S WEST lacks market power. The attached market analysis conducted by Quality Strategies shows that competitive providers have captured more than 70 percent of the retail market for high capacity services.[7] This is the most important market share statistic because the retail provider of high capacity services is the party that has the direct relationship with the customer. In fact, the customer may not even be aware of the identity of the

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[6] Upon completion of the AT&T/TCG merger, AT&T Chairman Michael Armstrong said "We're reducing our dependence on Bell companies for direct connections to businesses." Armstrong also pledged "substantial resources" to continue building facilities in key markets, and has mentioned $1 billion for TCG's share of continuing AT&T capital expenses. Communications Daily, July 27, 1998.

carrier actually provisioning the underlying high capacity facilities. Therefore, the retail provider has a significant marketing advantage over the facilities provider and, in the case of U S WEST's competitors, the ability to offer a full service package to the customer that includes interLATA voice and data services.

In addition, expansion of competitive providers' business has been even more rapid than the impressive 13 percent growth in the demand for high capacity services in the Phoenix market. During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the "provider" segment (i.e., high capacity services ultimately purchased by end users) increased from less than six percent to 28 percent.[8] The competitive providers' market share of the "transport" segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly, increasing from five percent to 16 percent between the second quarter and the fourth quarter of 1997 alone.[9] Perhaps the most significant trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured 54 percent of the growth in demand of the provider segment and 42 percent of the growth in demand of the transport segment.[10] Share of growth is the primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers

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[7] See Attachment A (Quality Strategies, U S WEST High Capacity Market Study, Phoenix Metropolitan Statistical Area, dated Aug. 7, 1998, at 17 ("Quality Strategies Report")).

[8] Id. at 16.

[9] Id. at 14.

[10] Id. at 15.

in the Phoenix area have captured a majority share of market growth over the past several years.

It also is important to consider the fact that existing competitive fiber networks could absorb all of U S WEST's high capacity traffic at less than eight percent capacity.[11] The only real constraint on competitive providers expanding service to U S WEST's customers is the need to build facilities to connect these sites to their existing fiber backbone networks. In most cases, this is not an issue at all. Approximately 65 percent of U S WEST's current high capacity demand (DS1 equivalents) in the Phoenix area is located within 100 feet of existing competitive provider fiber networks, which means that it is essentially located "on-network." Thus, competitive providers could absorb a majority of U S WEST's high capacity demand almost immediately, incurring only minimal costs.

Moreover, as the attached report prepared by POWER Engineers, Inc. ("PEI") demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand.[12] Specifically, competitive providers in Phoenix can serve the almost 50 percent of U S WEST's high capacity customer locations within 1,000 feet of their existing fiber networks if they invest $45 million,[13] and all of U S WEST's high capacity customer locations within 9,000 feet of their existing fiber networks if

[11] Id. at 29.

[12] See Attachment B (POWER Engineers, Inc., Phoenix Cost Study & Model, Aug. 13, 1998 ("PEI Study")).

[13] Id. at 3. These locations account for approximately 86% of all U S WEST's current high capacity demand in the Phoenix area.

they invest approximately $127 million.[14] Given that U S WEST's share of the Phoenix area market for high capacity services is worth approximately $50 million on an annual basis and the fact that the market has been growing steadily at about 13 percent annually, it is economically rational to assume that competitive fiber networks would be able to absorb most, if not all, of U S WEST's existing customers within a relatively short period of time.

The noted economists Alfred E. Kahn and Timothy J. Tardiff have analyzed the market share and competitive fiber network data for the Phoenix area high capacity services market following the approach the Commission previously has used to assess market power for other services.[15] They conclude that "the market for high capacity services in the Phoenix area fully exhibits the indicia of competition that the Commission has prescribed."[16] In light of U S WEST's lack of market power, Kahn and Tardiff affirm that competition itself, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of services.

Indeed, Kahn and Tardiff conclude that continuing dominant carrier regulation of U S WEST's high capacity services in this highly competitive

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[14] Id. These locations account for approximately 95% of U S WEST's current high capacity demand in the Phoenix area.

[15] See Attachment C (Alfred E. Kahn and Timothy J. Tardiff, Economic Evaluation of High Capacity Competition in Phoenix, Aug. 18, 1998, at 1 ("Kahn and Tardiff Paper")).

[16] Id.

environment would be "anti-competitive and injurious to consumers."[17] U S WEST is the only carrier in the market that is required to file tariffs on up to 15-days notice and provide cost support.[18] Not only does this impose an unnecessary regulatory burden on U S WEST, but it gives competitive providers advance knowledge of U S WEST's rates, thereby providing these competitors with an unfair opportunity to quickly implement a market response before the filed rates can even take effect. U S WEST also is the only carrier that is required to charge uniform rates throughout the entire State of Arizona (i.e., the Arizona study area), which means that U S WEST is prohibited from responding to competitive initiatives of other carriers.[19] The end result is that competitive providers can undercut U S WEST's prices and cherry-pick the most desirable customers. The disparate regulation of U S WEST as compared to every one of its competitors places U S WEST at a severe competitive disadvantage in the high capacity services market in the Phoenix MSA.

U S WEST's Petition seeking relief from dominant carrier regulation in the Phoenix area market for high capacity services satisfies the statutory criteria for forbearance. First, dominant carrier regulation of U S WEST's high capacity

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[17] Id. at 3.

[18] See, generally, 47 C.F.R. §§ 61.38, 61.41-61.49.

[19] 47 C.F.R. § 69.3(e)(7) (access tariffs filed by price cap LECs "shall not contain charges for any access elements that are disaggregated or deaveraged within a study area that is used for purposes of jurisdictional separation"). Although U S WEST is permitted to establish density pricing zones for access elements, pricing for each density pricing zone must be uniform within a study area. 47 C.F.R. § 69.123.

services is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory. U S WEST does not have the power to control price in this market nor the ability to act in a discriminatory manner. Second, because U S WEST cannot control prices or act in a discriminatory manner, the imposition of dominant carrier regulation on U S WEST's high capacity services simply is not needed to protect consumers in the Phoenix MSA. Third, continuing to subject U S WEST's high capacity services in the Phoenix area to dominant carrier regulation deprives customers of the benefits of true competition by imposing unnecessary regulatory costs on U S WEST and hampering its ability to quickly and effectively respond to competitive initiatives. In sum, continued dominant carrier regulation of U S WEST's high capacity services in the Phoenix MSA harms the public interest and contravenes the pro-competitive goals underlying the 1996 Act.[20]

Finally, U S WEST emphasizes that it is <u>not</u> requesting that its high capacity services be deregulated – it is requesting only that the Commission exercise its Section 10 forbearance authority and regulate U S WEST as a non-dominant carrier in the high capacity services market in the Phoenix MSA. As a non-dominant provider, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of

[20] Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 230, 104 Congress, 2d Session 113 (1996).

lawfulness and without any cost support.[21] The Commission also should free U S WEST's high capacity services from price cap and rate of return regulation, which are appropriate only for dominant carrier services.[22] Moreover, the Commission should forbear from applying Section 69.3(e)(7) of its rules so that U S WEST can charge deaveraged rates within the Phoenix MSA. The effect of granting U S WEST's Petition would be to place U S WEST on equal footing with all other competitors in the Phoenix area market for high capacity services.

II. U S WEST SHOULD BE DECLARED NON-DOMINANT IN THE PHOENIX MARKET FOR HIGH CAPACITY SERVICES

U S WEST's classification as a dominant carrier in the high capacity services market dates back to 1980, when the Commission found that AT&T, including its 23 associated telephone companies, dominated the telephone market.[23] Since that time, the high capacity services market has evolved from a market containing only a few competitors into a highly competitive market containing many competitors. Further, Congress adopted a number of market-opening requirements as part of the 1996 Act. These statutory requirements have had the effect of accelerating the competition that was already occurring in the high capacity services market and

[21] In the Matter of Hyperion Telecommunications, Inc. Petition Requesting Forbearance, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 12 FCC Rcd. 8596 (1997) (forbearing from requiring non-incumbent local exchange carrier ("LEC") providers of exchange access services to file tariffs) ("CAP Forbearance Order").

[22] 47 C.F.R. §§ 61.41-61.49; 47 C.F.R. § 65.

[23] In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, First Report and Order, 85 F.C.C.2d 1, 22-23 ¶¶ 60-63 (1980).

ensuring that the market remains competitive. By any measure, competitive telecommunications carriers are experiencing phenomenal growth and success in the Phoenix MSA and have evolved into a mature industry.

As demonstrated below, U S WEST cannot exercise market power in the Phoenix area market for high capacity services. If U S WEST were to attempt to raise prices, either directly or through restricting output, its customers would quickly abandon U S WEST for one of the various competitive providers in the market. Yet U S WEST remains subject to the full panoply of dominant carrier regulations while all of its competitors enjoy the benefits of streamlined regulation. The Commission should exercise its Section 10 forbearance authority and regulate U S WEST in a manner commensurate with its non-dominant position in the high capacity services market.

A. Defining The Relevant Product And Geographic Market

The first step in analyzing market power is to determine the relevant product and geographic markets.[24] This approach allows for assessment of the market power of a particular carrier based on unique market situations by recognizing, for example, that "carriers may target particular types of customers, provide specialized services, or control independent facilities in specific geographic areas."[25] In its Petition, U S WEST has carefully limited the scope of relief to the products

[24] In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd. 3271, 3285 ¶ 19 (1995) ("AT&T Reclassification Order").

and geographic area which are shown to be competitive in the attached market analysis and engineering report.

1. High Capacity Services

The Commission has defined a relevant product market as a service or group of services for which there are no close demand substitutes.[26] In accordance with the Commission's analytical framework, U S WEST has defined the relevant product market as dedicated high capacity circuits provisioned at capacities of DS1 and above for purposes of the instant Petition. These high capacity circuits may be used to transmit voice, data, or both, and may utilize either wireline or wireless technology. While high capacity circuits may be provisioned at varying bandwidths using different technologies, they share the characteristic of offering business, government and carrier customers substantial bandwidth on a dedicated basis.

The Kahn and Tardiff Paper confirms that services provided to customers with usage sufficiently great to be economically served with high capacity facilities define the relevant product market.[27] In terms of the standard established by the Merger Guidelines, customers for lower capacity facilities would not shift their

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[25] In the Matter of COMSAT Corporation, File No. 60-SAT-ISP-97; IB Docket No. 98-60; File No. 14-SAT-ISP-97; RM-7913; CC Docket No. 80-634, Order and Notice of Proposed Rulemaking ¶ 27 (1998) ("Comsat Reclassification Order").

[26] Id. ¶ 25 (citing LEC Classification Order ¶¶ 41, 54 (In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd. 15756 (1997) ("LEC Classification Order"))).

[27] Attachment C, Kahn and Tardiff Paper at 3.

demands to high capacity facilities in response to a "small but significant" price increase in their current services, because the monthly cost of hooking them up for high capacity access is as much as six to seven times their current basic monthly charges.[28] Because high capacity access and low capacity access are not substitutable on the demand side, low capacity services are in a separate product market.[29]

2. Geographic Scope of the Market for Dedicated High Capacity Services

As the Commission recently explained, a "relevant geographic market aggregates into one market those consumers with similar choices regarding a particular good or service in the same geographical area."[30] U S WEST's Section 10 Petition seeks regulatory relief only for the Phoenix MSA because within this market there is an identifiable class of competitors providing high capacity services. Kahn and Tardiff note that the geographic scope for high capacity facilities from the supply side is the metropolitan area.[31] A metropolitan area tends to be the area

[28] Id. at 4 (citing Merger Guidelines).

[29] Id.

[30] Comsat Reclassification Order ¶ 27; see also In the Applications of NYNEX Corporation and Bell Atlantic Corporation For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd. 19985, 20016-17 ¶ 54 (defining relevant geographic area as "an area in which all customers in that area will likely face the same competitive alternatives" for a relevant service) ("Bell Atlantic/NYNEX Order").

[31] Attachment C, Kahn and Tardiff Paper at 5. This definition is consistent with the use of the MSA as the relevant geographic market. The U.S. Census Bureau describes the general concept of an MSA as "that of a core area containing a large population nucleus, together with adjacent communities having a high degree of

within which a provider announces the availability of its service and the area within which a provider can expand in a timely fashion to offer services to a growing number of locations.[32] In this case, the PEI Study demonstrates that competitors can economically expand to serve almost half of U S WEST's existing high capacity customer locations in the Phoenix area (representing 86 percent of its existing high capacity demand) within 18 to 24 months.[33]

U S WEST also limits the geographic scope of its Petition so that it covers only that area for which U S WEST has irrefutable evidence of competition. The attached Quality Strategies Report (Attachment A) shows that U S WEST faces intense competition from established facilities-based providers in the provisioning of high capacity services in the Phoenix MSA. In fact, competitive providers have substantial market share and more than sufficient network capacity to absorb U S WEST's existing business should U S WEST attempt to exercise market power. In addition, the PEI Study demonstrates that competitive providers could expand their existing networks at relatively little cost to serve U S WEST's existing high capacity customers in the Phoenix area. Based on this evidence, Kahn and Tardiff conclude that the Phoenix area market for high capacity services is highly

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economic and social integration with that core." http://www.census.gov//population/www/estimates/aboutmetro.htm.

[32] Attachment C, Kahn and Tardiff Paper at 5. That is not to say that competitive providers are limiting their competitive entry to the Phoenix MSA. GST, for example, describes itself as a "super-regional" competitive LEC and is clearly focused on increasing its statewide presence in Arizona. http://www.gstcorp.com/annual97.

[33] Attachment B, PEI Study at 3.

competitive and that U S WEST does not have the ability to exercise market power.[34]

B. The Phoenix Market For High Capacity Services Is Robustly Competitive

In assessing market power, the Commission is guided by well-accepted principles of antitrust analysis to determine whether a carrier is dominant in the relevant product and geographic market.[35] The Commission has relied on several factors as part of this analysis, including: (i) market participants; (ii) market share; (iii) the demand elasticity of customers; (iv) the supply elasticity of the market; and (v) the carrier's cost, structure, size and resources. Assessment of these general characteristics of the Phoenix area market for high capacity services demonstrates that U S WEST cannot exercise market power.

1. Market Participants

The Phoenix market for high capacity services is characterized by a number of established competitors with substantial resources. The following is a brief description of the five facilities-based market participants discussed in the Quality Strategies market analysis:

ELI has over 400 route miles of fiber in the Phoenix area and 30 to 45 buildings on its network.[36] ELI also claims to have invested $37 million in new

[34] Attachment C, Kahn and Tardiff Paper at 20-21.

[35] Comsat Reclassification Order ¶ 67.

[36] Attachment A, Quality Strategies Report at 26.

facilities in Phoenix.[37] Far from being a start-up, ELI is a subsidiary of Citizens Utilities Company, a large utility company and full-service telecommunications services provider.[38]

Moreover, ELI is a rapidly growing company. In 1997 alone, ELI's revenues increased 95 percent, from $31.3 million to $61.1 million. ELI's network services revenue (which includes private line services) increased from $18.7 million in 1996 to $33.5 million in 1997, an increase of 78.9 percent.[39] In addition, ELI's route miles increased from 1,428 to 2,494, an increase of 74.6 percent, and its fiber miles increased from 97,665 miles to 140,812 miles, an increase of 44.2 percent.[40]

<u>GST</u> has approximately 300 route miles of fiber in Arizona, including more than 11 miles of fiber in downtown Phoenix and a long haul fiber link between Phoenix and Tucson.[41] GST has wired 15 to 25 buildings on its network. GST also installed more than 50,000 access lines in 1997 and 16,000 additional access lines in the first quarter of 1998.[42] In the first quarter of 1998, GST acquired a long distance company, Call America Phoenix.[43]

<u>MCI</u> has 20 to 40 route miles of fiber in the Phoenix area and 25 to 35

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[37] http://www.eli.net/phxswitch.html.

[38] http://www.eli.net/history.html. Citizens Utilities had revenues of $1.4 billion in 1997, an increase of 8% over 1996. http://www.czn.net/PressReleases/pr031298.html.

[39] http://www.eli.net/annual.pdf.

[40] <u>Id.</u>

[41] Attachment A, Quality Strategies Report at 26.

[42] http://www.gstcorp.com/investors/March10k.html.

[43] http.//www.gstcorp.com/press/gen86.html.

buildings on its network.[44] The merger of MCI and MFS WorldCom (see below) is currently pending.

MFS WorldCom has 75 route miles of fiber in the Phoenix area and more than 50 buildings on its network.[45] The merger of MFS WorldCom and MCI (see above) is currently pending.

TCG has over 300 route miles in the Phoenix area and more than 150 buildings on its network.[46] The merger of TCG and AT&T was recently completed. AT&T already has begun the process of migrating all of its dedicated high capacity traffic from U S WEST to TCG.

Clearly, none of these providers of high capacity services can be classified as "start-up" companies. According to Quality Strategies, ELI and TCG entered the market in 1994, MFS WorldCom entered the market in 1995, MCI entered the market in 1996 and GST entered the market in 1997. Further, these companies have access to financial resources equal to or greater than U S WEST's that can be used to fund expansion of their networks serving Phoenix customers of high capacity services. For example, in the past two years, WorldCom acquired two competitive providers, MFS and Brooks Fiber, for a combined price of $16.4 billion – an amount almost identical to what SBC paid to acquire Pacific Telesis. The combined MCI and MFS WorldCom company will have 22 million customers and

[44] Attachment A, Quality Strategies Report at 25.

[45] Id.

[46] Id.

annual revenues of $32 million in 1998.[47] Similarly, AT&T recently acquired TCG at a cost of $11.3 billion and announced its intention to acquire TCI at a cost of $48 billion. The sheer size of the combined AT&T/TCG and MCI/MFS WorldCom companies dwarfs U S WEST.

Equally as important, the recently completed merger of TCG with AT&T, and the pending merger of MCI with MFS WorldCom, will result in the largest purchasers of high capacity services in Phoenix having their own competitive fiber networks. This is a significant development, given that AT&T/TCG and MCI/MFS WorldCom account for approximately half of U S WEST's high capacity businesses in the Phoenix MSA. In fact, U S WEST already is experiencing the effects of these mergers, as significant portions of these customers' high capacity services have been migrated to the affiliated competitive fiber networks. Kahn and Tardiff observe that "[i]t would be difficult to conceive of a more substantial consequent diminution of whatever market power [U S WEST] might previously have enjoyed."[48]

U S WEST's experience with AT&T is illustrative. AT&T began migrating circuits from U S WEST to competitive provider facilities during the third quarter of 1997 and since then has disconnected a majority of its U S WEST-provided circuits and migrated them to alternative providers. Now that AT&T has completed its merger with TCG, AT&T has pledged to further reduce its dependence on

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[47] http://investor.mci.com/merger_overview/merger2.htm.

[48] Attachment C, Kahn and Tardiff Paper at 6.

U S WEST and other Bell companies and to commit "substantial resources" to continue building TCG facilities.[49]

In addition to giving AT&T and MCI access to their own high capacity facilities, the consolidations of AT&T and MCI with facilities-based access providers will result in the merged companies now competing head-to-head with U S WEST in the Phoenix area market for high capacity services. Therefore, AT&T and MCI have an incentive to oppose U S WEST's Petition purely for their own business purposes.

2. Market Share

U S WEST's steadily declining market share for high capacity services in the Phoenix MSA supports the conclusion that U S WEST lacks market power.[50] Quality Strategies uses DS1 equivalents as the basis for its market share calculations because DS1 bandwidth is deemed the baseline for the high capacity services market.[51] As discussed above, the high capacity services market encompasses both voice and data traffic, and wireline and wireless technologies. For analytical purposes, Quality Strategies describes the Phoenix area market for high capacity services as a three-tier market, with U S WEST and other providers selling services to end users, resellers and other carriers for transport purposes.[52] As depicted below, this market can be sub-divided based on who high capacity

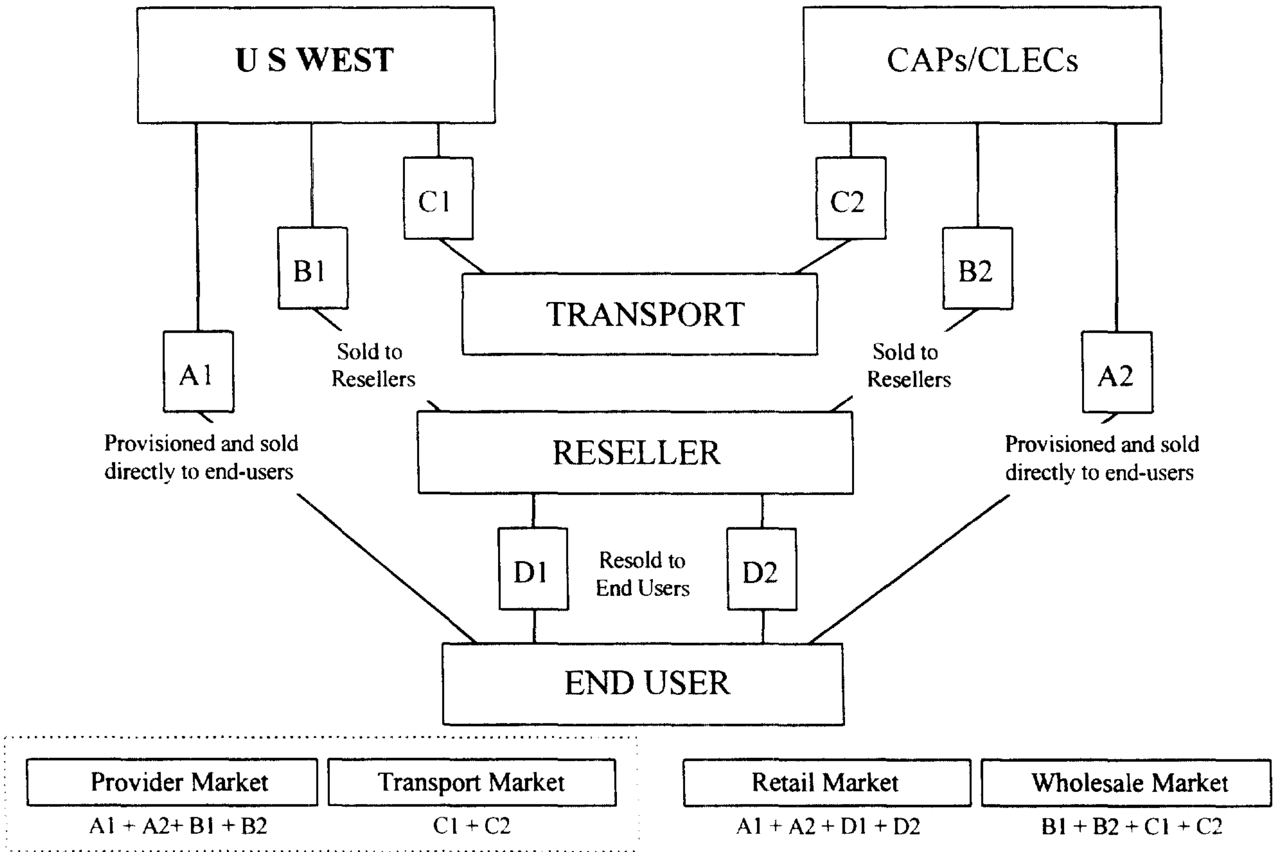
[49] Communications Daily, July 27, 1998.

[50] See AT&T Reclassification Order, 11 FCC Rcd. at 3307 ¶ 67.

[51] Attachment A, Qualities Strategies Report at 35.

[52] Id. at 9-10.

services are sold to – retail and wholesale segments – versus who is ultimately using the underlying facilities – the "provider" and "transport" segments.[53]



The attached market analysis conducted by Quality Strategies shows that competitive providers have captured more than 70 percent of the retail market for high capacity services.[54] This is the most important market share statistic because it identifies the carrier that has the direct account relationship with the customer. In fact, the customer may not even be aware of the identity of the carrier actually provisioning the underlying high capacity facilities. Therefore, the retail services provider has a significant marketing advantage over U S WEST when it is only the

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[53] Id.

[54] Id. at 17. The combined AT&T/TCG and MCI/MFS WorldCom companies comprise over 50% of the retail market. Id.